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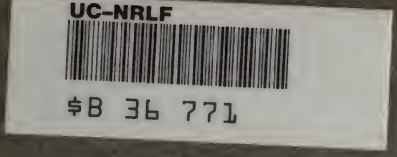

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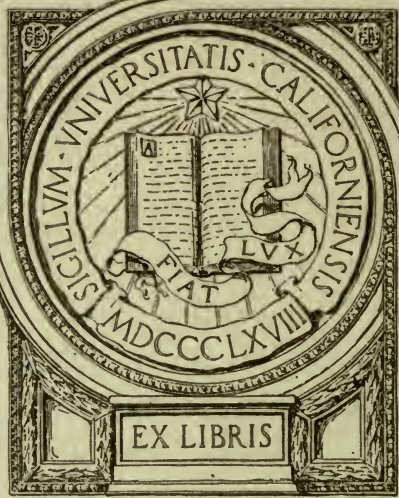
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War Taxation

Some Comments and Letters

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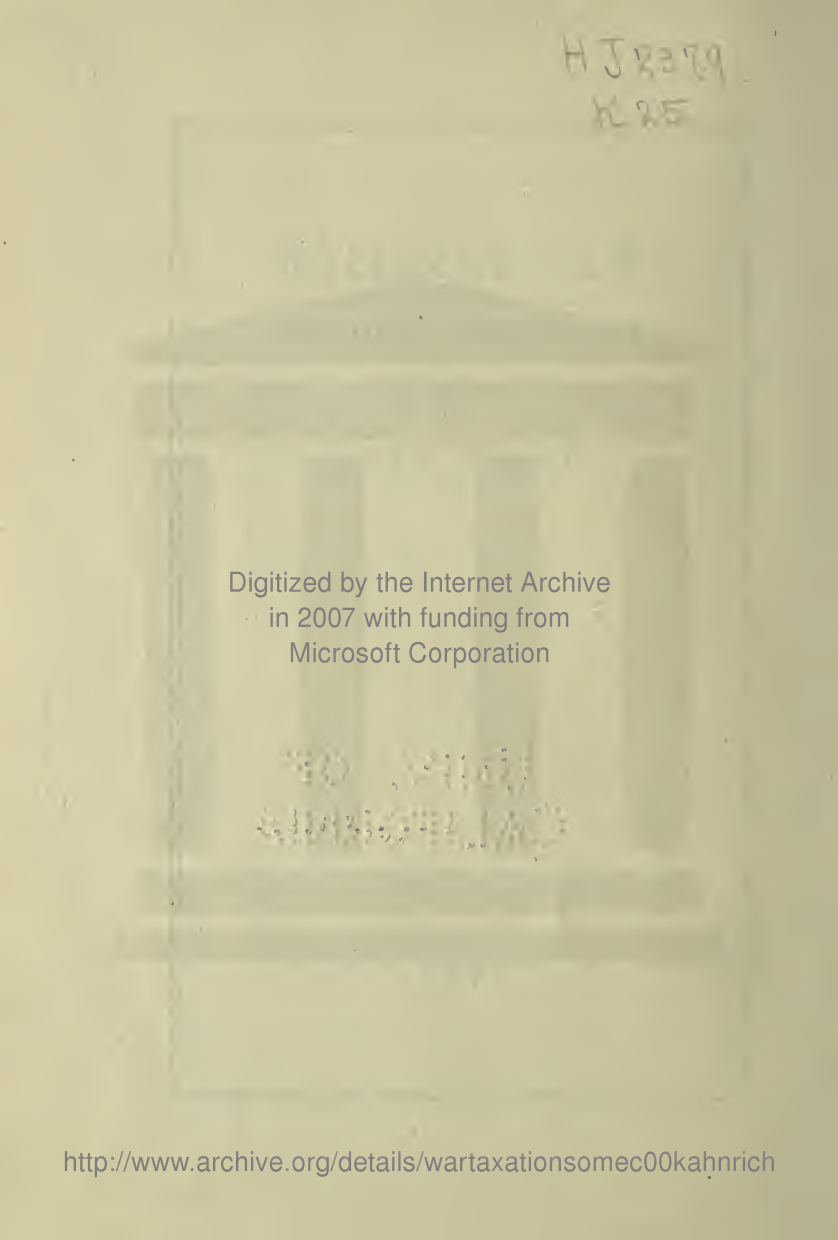

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War Taxation

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War Taxation

The recent publication of a little pamphlet entitled "Some Comments on War Taxation" elicited numerous interesting comments by the readers. The points to which these comments mainly related were the statements contained in the pamphlet that:

First. If our neighbor Canada continues her present policy of not taxing incomes, or if she imposes only a moderate tax while rates of income taxation in America are fixed at oppressively and unnecessarily high rates, there can be little question that the ultimate result will be an outflow of capital to Canada, and that men of enterprise will seek that country.

Second. Moneyed men not having their capital engaged in active business, if they are so constituted that their consciences permit them to evade their share of monetary sacrifice, can put their funds into tax-exempt securities.

In reference to the foregoing points, I have written two letters in answer to correspondents. These letters contain an elaboration of certain arguments and viewpoints set forth in the original article on War Taxation and also refer to some additional phases of the subject. Those who have done me the honor of perusing that article may possibly be interested in reading these letters.

In order that they may be presented as a part of the argument as a whole, the original article with a few additions and slight revisions is printed in the first part of this pamphlet, followed by the letters.

O. H. K.

52 William Street,
New York, July 5, 1917.

UNIV. OF CALIFORNIA

SOME COMMENTS ON WAR TAXATION

This is a reprint, somewhat amplified, of an article printed recently in the New York Times. The original article was written before the recommendations of the Ways and Means Committee of the House of Representatives were reported

IN A TIME of patriotic exaltation and of universal obligation and readiness to make great sacrifices to bring a most just and righteous war to a successful conclusion, the voice of sober argument and matter of fact considerations is apt to grate upon the ears of the people.

That voice is all the less likely to be popular when the arguments it puts forth may easily lend themselves to the interpretation of being actuated by solicitous care for selfish interests.

I am fully aware that by publishing the following observations I am exposing myself to that interpretation and to criticism of, and attack upon, my motives.

Yet, seeing that certain measures now under consideration threaten to take shape in a way which, from my practical business experience and after mature deliberation, I am bound to regard as faulty and as indeed harmful to the country, I believe it to be right and proper to contribute my views to the public discussion of the subject, for whatever they may be worth.

I can only hope, then, that in what I am going to say I shall be given credit for endeavoring to speak conscientiously and to the best of my knowledge and judgment from the point of view of the welfare of the entire country and not of the welfare merely of the well-to-do.

I shall address myself to the practical

aspect and to a few phases only of the question and shall not attempt to enter into the economic theories and the broader and deeper considerations involved.

I shall assume in my argument that what Congress is seeking to accomplish is to impose taxes justly, effectively and scientifically with the desire to disturb the country's trade and commerce as little as possible and to avoid as much as may be the evils of financial dislocation.

I shall take it for granted that at a time when more than ever the unity of the country should be emphasized, sectional selfishness will find no place in the taxation program, and that, should it be attempted nevertheless, the congressional delegations of the States which would be unjustly affected, would resist, regardless of party affiliations, harmful discrimination against their constituents and their States.

I shall assume that it is not the purpose and intent of Congress, under the guise of the necessities of the war situation, to embrace the doctrines of Socialism.

Our present economic system, our present method of wealth distribution may or may not stand in need of change; the fact remains that Congress has no mandate to effect a fundamental change.

The consequence of such a change would be so immensely far-reaching that no government has the right to sanction steps to bring it about until the subject has been fully discussed before the people in all its bearings and the people have pronounced judgment through a Presidential or other election.

I will first state what in my opinion ought *not* to be done:

I

I take it that not many words need be used to expose the fallacy of the argument, heard even in the Halls of Congress: "If men are to be conscripted, wealth also must be conscripted."

Men will be conscripted to the extent that it is wise and just and needful. So, and no other, should wealth and the country's resources in general be conscripted.

And, are not the children of the well-to-do conscripted equally with the children of the poor?

Indeed, the proportion of the sons of the well-to-do on the actual fighting line is bound to be a predominating one, because vast numbers of wage workers in

the industries and on the farms will necessarily have to be retained at their accustomed vocations in order to maintain the output of our factories and farms.

Have the children of the well-to-do been backward in volunteering? Were they not, on the contrary, amongst the very first to offer to serve and to fight?

II

There appears to prevail amongst not a few people the strange delusion that America's entrance into the war was fomented by moneyed men, in part, at least, from the motive and for the purpose of gain.

Were there any such men, no public condemnation of them could be too severe, no punishment would be adequate. I am absolutely certain that no such hideous and dastardly calculation found lodgment in the brain of any American, rich or poor.

Moreover, is it not perfectly manifest that any rich man in his senses must have known that his selfish interest was best promoted by the continuance of the conditions of the last three years in which America furnished funds and supplies to

Europe at huge profits, whilst our entering the war was bound to diminish those profits very largely (indeed, to entirely eliminate some of them), to interfere with business activity in many lines and to compel the imposition of heavy taxes on wealth?

It is to the credit of our rich men that, though fully realizing the extent of the monetary loss and sacrifices which war between this country and Germany must necessarily bring to them, there were but very few of them who supported the Peace-at-any-Price Party or favored the avoidance of America entering into the war when it had become plain that our participation in that war could not be avoided with honor and with due regard for our duty to our own country, or to the cause of right and liberty throughout the world.

Yet, somehow, the pacifists seem to

have singled out the rich as mainly responsible for the war.

It may be due, consciously or unconsciously, to a resulting feeling of resentment that *the proposal to confiscate during the war all incomes beyond a certain figure is actively promoted by leading pacifists*—a proposal based upon ignorance of, or disregard for, the laws of economics, teachings of history and practical considerations.

If any such scheme were to be adopted, the consequences to the country at large would be far more serious than to the victims of the proposed action.

If such a measure of outright confiscation were seriously apprehended, at a time moreover and under conditions which are far as yet from calling for extreme measures, capital would cease to flow in its accustomed currents and some

of it would seek other channels legitimately open to it.

It would certainly cease flowing into constructive use and would instead confine itself, to an extent at least, to municipal, state and federal tax-exempt securities. Enterprise would be seriously hampered and in some respects brought to a standstill entirely.

Many thousands of workmen would be thrown out of employment. Many businesses and shops would close.

There would ensue, as a natural consequence and without any conscious determination, a nation-wide strike of constructive activity and enterprise in commerce and finance, because men will not look upon it as a "square deal" if they are to take all the risk and responsibility, all the hard work and ceaseless strain and care of business effort, whilst the Government would *needlessly* take from them an

unduly large share of the fruit of their labor, let alone all of it except an arbitrarily fixed sum.

I say "needlessly" because, *were it really needed, business men would willingly sacrifice their entire income for the country's cause.*

They would work for patriotism, without any recompense whatever, just as hard and harder than they do for gain or for ambition, if the occasion required it.

But, of course, everyone knows that nothing remotely approaching such drastic taxation is required in this country at this time.

It is absolutely right to proclaim and to enforce by legislation that no man, as far as it is possible to prevent it, shall make money *out of a war* in which his country is engaged, but there is all the difference in the world

between that just and moral doctrine and between the doctrine that no man shall be permitted to have more than an arbitrarily fixed income *during* a war.

If $100,000 or any fixed sum is the limit of what may be permissible income during war time, why not by and by a lesser sum?

If the principle is once admitted, where will its application stop, even in time of peace?

Why is not the proposed plan, or anything in the nature of that plan, simply license for the materially unsuccessful to despoil the materially successful?

History shows more than one instance where this road inevitably leads to when once entered upon.

And who are our successful men? The vast majority of them are self-made men who started at the bottom of the ladder.

It is trite to say that inequality of endowment and therefore inequality of results in human beings, as well as in inanimate things, is a law of nature. The capacity for creating, organizing, leading, etc., in short, the possession of those qualities of brain and disposition which beget success, is rare.

It is in the interest of the community, whilst carefully guarding and fostering the rights, the opportunities and the well-being of all of its members, to give liberal incentives to men possessing those gifts to put them to active and intensive use. It is hardly open to doubt that, generally speaking, the work of able men, engaged in serious and legitimate business (I am not speaking of gamblers and parasites), whilst naturally benefiting them, benefits the community a great deal more.

The income of hospitals, orphan asylums, institutions of learning and of

art and many other altruistic enterprises depends largely upon the voluntary taxation, aggregating a great many millions annually, to which those men in America who have attained financial success have always willingly submitted themselves—more so, probably than in any other country.

Who is to take care of all of those institutions if extreme taxation compels the rich to cease their contributions?

III

The arguments above set forth apply likewise, though naturally not quite in the same degree, to the proposal of levying an income tax rising to an excessively high level, as, for instance, the suggested tax of fifty per cent. on incomes over $500,000.

There, again, the test should be whether so radical a tax is wise and required by the necessities of the country.

The nations in Europe have been fighting for nearly three years and have been under an infinitely greater financial strain than our country is or will be, yet none of these nations have resorted to extreme taxation of income.

Even in Great Britain, whose financial burden is the heaviest of all, whose debt

is many times the total of ours and who has loaned about $5,000,000,000 to her Allies, the highest income tax rate, the maximum percentage in the graduated scale of taxation, is to-day no more than approximately forty per cent.

In the last budget, introduced a couple of weeks ago, the British Chancellor of the Exchequer declined, so I am informed, to consider an increase in the income tax rate, because of the damaging effect which such increase would be apt to have on the country's business and prosperity.

In France and Germany the burden laid on incomes is much lower than in England. *In Canada* where war loans have been raised equivalent on the basis of comparative population to what would be more than $10,000,000,000 for America, *no Federal Income Tax exists at all.*

I doubt whether this latter fact is generally known in this country and whether

its significance is receiving the measure of serious consideration which it deserves.

I understand that it is the deliberate policy of the Dominion Government to endeavor to avoid resort to an income tax in order to attract capital to Canada.

There can be little question that if our income taxation is fixed at unduly and unnecessarily high rates, whilst Canada has no or only a very moderate income tax, men of enterprise will seek that country and there will be a large outflow to it of capital in course of time—a development which cannot be without effect upon our own prosperity, resources and economic power.

The financial dislocation, the discouragement and the apprehension caused by unduly heavy taxation of incomes will not only act as a drag on enterprise and constructive activity, but will make it exceedingly difficult, if not impossible, for

corporations to sell securities in sufficient volume and thus to obtain adequate funds to conduct their business—especially also as investors will be fearful that high rates of taxation once established will not easily be reduced to normal levels, even when the present emergency is passed.

Extravagance, log-rolling, the unwise and inefficient expenditure of money by governmental bodies are amongst the besetting sins of democracy. The formula once found, the machinery once employed for the raising of huge revenues, are apt to make the way of wasteful governmental spending all too temptingly easy.

It must not be forgotten that taxation must necessarily by that much diminish the surplus income fund of the individual and that both theoretically and actually the spending of money by the government cannot and does not have the same

effect upon the country's prosperity and enterprise as productive use of his surplus funds by the individual.

The sentimental, and thereby the actual, effect of extreme taxation will not be confined to the relatively small number of people in possession of very large incomes. The disturbance and fear caused by the contemplation of an excessively high ratio of taxation, even when applied to a relatively few, is bound to spread to those also of more moderate incomes.

Capital is proverbially timid. It will not take risks, except in the expectation of commensurate reward, and if it sees the danger of its reward being unduly infringed upon by excessively rigorous income taxation, it will anticipate that menace by withdrawing from the field of constructive investment to the greatest extent possible.

So much is this the case that I incline to

the belief that *taxation so graded as to result in a maximum average of say* 33⅓ *per cent. would produce at least as great a revenue as a maximum average of* 50 *per cent.*

It is one of the oldest principles of taxation that an excessive impost destroys its own productivity.

The flood of securities which would be coming for sale in order to escape extreme income taxation would create a grave condition of demoralization in the investment markets of the country, with the resulting inevitable effect upon the country's general business, and upon its capacity to absorb Government loans.

IV

The tax recently enacted by Congress imposing a burden of 8 per cent. on business profits over and above 8 per cent. on the capital employed, regardless of whether such profits have any relation to war conditions or not, is unscientific and unsound.

(Incidentally, it is a strange provision of that law that it applies only to co-partnerships and corporations, whilst an individual engaged in business, however profitable, is not taxed.)

It is unquestionably right and in accordance with both good morals and good economics, to prevent, as far as possible, the enrichment of business and business men through the calamity of war.

But the recently enacted so-called excess profit tax which it is now proposed to augment largely does not accomplish that. It taxes not merely the exceptional profit, *i. e.*, the war profit. It lays a burden not on business due to war, but on all business.

It does this at a time when it is more than ever necessary that energy, enterprise, efficiency, the commercial and financial brain and work-power of the nation, be stimulated to their utmost in order to make good, as far as possible, the waste and destruction which go with war.

Any scheme of taxation which imposes an unnecessary burden upon commercial enterprise and thereby handicaps the nation in its business activities—especially in world competition with other nations—is unsound and bound to be gravely detrimental, both to the business men and still

more to the wage-worker; in fact, to every element of the population.

It is worth noting that England, the conduct of whose finances, based upon the experience of many generations as the leading financial power, has always been a model for other nations to follow, has imposed an excess profit tax on business during the war *merely* to the extent that such profits are attributable to the war, *i. e.*, to the extent that they exceed the profits of normal years.

In principle, direct taxation of business activities should be avoided as much as possible, apart from a *war profit excess* tax.

Care should be taken lest the wealthy man least entitled to preferential consideration, *i. e.*, he who neither works nor takes business risks or business responsibilities, be favored as against the man who puts his brains, his capacities and his

money to constructive use in active business.

The idle man possessing capital, much or little, if he is so constituted that his conscience permits him to evade his share of monetary sacrifice, can put his money into tax-exempt securities. The man of means who toils in business or a profession must pay a heavy income tax, an excess profit tax, etc. To an extent this undesirable differentiation is probably unavoidable, but it is neither fair nor in the interest of the community that it be accentuated.

V

It seems to me so manifest as to hardly require argument that a retroactive income tax, such as has been suggested, is wrong both in morals and in economics.

If the foregoing reasoning is correct, these conclusions would seem to follow:

1. There ought to be a substantial and progressive increase in the rate of income taxation during the war, together probably with a lowering of the existing limit of income tax exemption. I believe that in practice the best result would be obtained if the rates of taxation were not to exceed a scale producing from maximum incomes an average tax of 33⅓ per cent., at any rate for the first year of the war.

A materially higher rate would not, in my opinion, yield a substantially higher aggregate of revenue to the Government (if as high an aggregate), while at the same time, if only for sentimental reasons, and even though only applied to very large incomes, it would be apt to cause

financial dislocation and retard business activity and enterprise.

It would seem advisable that such portion of a person's income as is devoted to charitable and kindred purposes should be, if not entirely free from income tax, at least subject to a reduced tax only, so as to counteract the tendency which experience has shown to follow in the wake of heavy taxation, of greatly diminishing charitable contributions.

2. There *ought to be an excess profit tax which might well be at a considerably higher rate than the present* 8 *per cent., or even the proposed* 16 *per cent.*, but it should only be applicable to the extent that business profits exceed the profits of say a certain average period before the war and thus may justly be held to be attributable to war conditions.

In determining the basis for calculating

excess profits, an offset which might be fixed at say 10 per cent. per annum, due consideration being given to the question of depreciation and to special circumstances, ought to be allowed on all new capital invested in business since the beginning of the war.

I think for the purpose of figuring the excess profit tax the five, four or three years *before America's entrance into the war* would probably form the most appropriate basis. The aggregate industrial plant of this country, the entire scale and scope of our commerce and its concomitants, have been so completely modified in the course of the European war that a comparison which leaves out of account the years 1915 and 1916 does not seem to me to fit the case. I believe, both from the point of view of economics and of public opinion, a tax of say 32 per cent. or even 40 per cent., or eventually,

if needed, a still higher percentage, calculated on a reasonably high average of earnings (that is, an average including 1916) is preferable to a tax of 16 per cent. or 20 per cent. on an inordinately low average.

I believe that as between the proposed 16 per cent. profit tax and an *excess* profit tax on the British model, at the rate of say twice that figure—to begin with—the general consensus of opinion would consider the latter as much the fairer, much the less cumbersome to handle and collect, and much the less hampering upon business activities. Yet, statistics seem to show that such an *excess* profit tax would bring in a far larger return than the proposed 16 per cent. profit tax. From figures which were shown to me it would appear that a 40 per cent. tax on excess profits over and above the average earnings for the past three years would

yield for the present year the amazing total of at least $800,000,000 (in addition to the yield from the corporate income tax taken at the rate of 4 per cent.).

These figures are based on the assumption that the aggregate profits for 1917 will approximately equal those of 1916—a not unreasonable assumption provided always that unscientific taxation or other unwise measures do not destroy prosperity. (As a matter of fact, the profits for the first half of 1917 are likely to exceed those for the same period of 1916.) The three-year average was selected on the theory that 1914 was an exceedingly poor business year, 1915 was a year of fair prosperity and in 1916 the full effect of our stupendous war business had come to raise profits to an exceedingly high level.

3. There are very numerous forms of taxes, stamp-taxes, etc. (such as, for

instance, a 2 cent tax on checks), which, whilst they would mainly fall on the well-to-do, would be in no way burdensome, and would produce a very large aggregate of revenue.

What seems to me in principle a very sensible tax, has been suggested, namely, *a tax on purchases* (*i. e.*, each single purchase) of all kinds of merchandise (excepting foodstuffs, and probably raw material) of one cent for each dollar or greater part thereof, exempting single purchases of less than say five dollars.

This tax, *which should be paid by the purchaser*, would produce a very large revenue. It would be borne mainly by the well-to-do, would be more widely distributed than almost any other form of taxation and would be felt but very little. It would be easily and cheaply collected and would begin to accrue much sooner than most other taxes.

4. I am not convinced that the total amount which needs to be spent or which as a matter of fact can be spent in the course of the year requires so huge a sum to be raised by taxation as our legislators appear to contemplate.

The policy of raising a large portion of war expenditures by taxation is wise and sound. But to be iconoclastic in applying that policy, to make that portion so large as to chill the spirit and lame the enterprise of the country is neither good politics nor good economics.

The present has its rights as well as the future. Sacrifices should be reasonably averaged. An annual sinking fund of 5 per cent. would extinguish the war debt in fifteen years.

5. Democratic England under two Prime Ministers belonging to the Liberal party has shown how huge amounts of

increased revenue—much greater relatively and greater even absolutely than are required in this country during the first year of the war—can be obtained by taxation without undue dislocation of the existing economic structure and without banefully affecting the country's prosperity. While it would not do for us to follow the English method of taxation in all respects, it would seem the part of wisdom for us to profit from her successful experience. And I hope it will not be deemed presumptuous if I venture to suggest that it might not be amiss for our Government in this connection to permit to the practical experience and judgment of business men some recognized scope in the deliberations, as I understand was freely done in England. I am entirely certain that the spokesmen for the business community would give their time, their best thought and their disinterested

service to the task of co-operating in devising a wise and fair scheme of taxation as fully, readily and patriotically as they have done and are doing to the task of placing the Liberty Loan.

6. In determining upon the scheme and detail of taxation, it should be borne in mind that the intent of the proceedings is not punitive, neither is it to apply practical Socialism under the guise of war finance.

Taxation is a problem in mathematics and national economics. It cannot be tackled successfully by hit or miss methods, or upon the impulse of the moment. It needs to be approached "*sine ira et studio*" if the best results are to be obtained for the country at large.

Congress and public opinion might well ponder the advice recently cabled here by

one of the leading financial writers in England: "You should go slow in your tax plans. Too violent a financial dislocation would be caused, unless taxation is most judiciously and scientifically apportioned."

The desire to place the financial burden incident to war preponderantly upon the wealthy is just and right, but even in doing things from entirely praiseworthy motives, it is well to remember the old French saying, that virtue is apt to be more dangerous than vice, because it is not subject to the restraint of conscience.

* * *

Since this article was published, I have received several letters stating that, owing to the excessively high cost of living and for other reasons, men of small means could not afford and should not be asked to bear additional taxation to any

appreciable extent and that therefore the proposed vast increase in the income tax is a necessity.

I fully agree with the premise, but not with the conclusion. Economics are stubborn things and cannot be successfully dealt with emotionally. I yield to no one in my sympathy for those who have to struggle to make both ends meet and in my desire to see their difficulties lightened. I quite agree that the financial burden of the war should be made to weigh as little as possible upon the shoulders of the poor and those of small means. Will a two-cent tax on checks be a burden upon the poor and those of small means? Will a five-cent tax on single purchases (excepting foodstuffs) of $5? Will an excess-profit tax on the lines which I propose? The list of similar queries could easily be continued.

The present cost of living is undoubtedly

alarmingly high. I believe this condition of affairs, to a certain extent at least, could be alleviated by appropriate measures and that every effort should be made to that end. But a huge increase in the income tax and unwise business taxation will not accomplish this. It will, in fact, rather accomplish the opposite, apart from lessening employment.

LETTERS

I

The Income Tax

Dear Sir:

I fully agree with you in the principle of your conceptions of the duties of moneyed men towards the country. They must be willing not only to surrender such part of their income, indeed of their fortune, as the necessities of the country require, they must be ready not only to relinquish their affairs and to put their time, their energies, capacities and experience at the disposal of the Government in time of war, but they must be prepared to offer their very lives if the country calls for them. Those are the duties, of course, of every citizen, but they are doubly the duties of those who

have won success. I am firmly convinced that capitalists as a class will not fail in them during the war.

My article on war taxation was not written with any idea of questioning these manifest and uncontrovertible truths, but solely with the purpose of contributing to the discussion of the taxation proposals certain considerations which I believe to be well founded in economics and history no less than in experience and reason, and the disregard of which would be apt, I think, to lead to consequences gravely detrimental to the commonwealth.

The question to which my article addressed itself was not what sacrifices capital should and would be willing to bear if called upon, but what taxes it was fair, reasonable and, above all, **to the public advantage** to impose on capital, seeing that there is a point at which the

country's economic equilibrium would be thrown out of gear and at which the incentive to use capital constructively and productively and to take those business risks which are incident to all business activity, would be killed.

I greatly regret if what I said on the subject of Canada being free from income tax gave the impression of being a suggestion for the evasion by wealthy men of taxation during the war. The fact that capital is not subject to income tax in Canada was, of course, well known to men of wealth. I thought it a point and a fact of sufficient importance as bearing upon our own taxation program to deserve to be made generally known. That this might be considered as either a suggestion or a threat of what capital might do during the war, never, I confess, entered my mind, *for it would, of course, be little short of treason for capital and*

capitalists to take advantage of Canada's propinquity while the war is on.

You speak of the possibility of legislation to prevent this. If capital meant to leave the country to evade taxation, there would have been ample time and opportunity for it to do so during the past six weeks. The price of exchange would indicate if that had been done to any appreciable extent, and proves, as a matter of fact, that it is not being done. If it were being done, I quite agree with you that legislation should be sought to prevent it and to punish the attempt. But I am entirely certain that moneyed men will not think of evading whatever sacrifice may be required of them by their country under war conditions.

What I meant to intimate in saying that capital and men of enterprise would seek Canada if there was no income tax, or only a moderate one, in that country,

whilst America at this time imposed excessive and practically punitive income taxation, was this:

Capital has a long memory. Capital is proverbially timid. I am not referring only to large aggregations of capital but to all capital. I am not referring only to the capital and capitalists of to-day, but to those who accumulate capital by practising thrift and to those who by invention, by conspicuous organizing or other ability, by originality of method, etc., are instruments in the creation of capital and will be, presumably, amongst the future owners of capital.

The possessors of capital, present and future, would not easily forget if, in the very first year of the war capital in this country were to be taxed at far higher rates than prevail in any European country after three years of war. Even if such extraordinary taxation was removed at

once, after the termination of the war, capital would remain disquieted by the fear that the machinery of excessively high income taxation, once used and found easy of motion, might be used again for purposes of a less serious emergency than now exists. Those seeking capital for other countries—*and there is bound to be a very keen contest for capital after the war*—would not fail to make use of these arguments. Moreover, experience has proved that very high rates of income taxation once adopted, are not easily reduced to the level from which they started.

Therefore, in the case to which my argument was addressed, *i. e.*, unduly high income taxation in this country and no, or only very moderate, income taxation in Canada, there can be little doubt that *after the war* there would be an outflow of capital to Canada, and that—

which is still more important—men of enterprise, especially young men, will be apt to seek in that and other countries, fields for their activities if the reward of enterprise is too greatly diminished in America as compared to what it is elsewhere. Such men would be doing nothing else than what many thousands of American-born farmers have done within recent years in transferring themselves, their capital and their working capacity to Canada.

Not a single one of the leading European nations, after three years of the most exhausting war, has an income taxation schedule as high as that adopted by the House of Representatives; neither Republican France, nor Democratic England, nor Autocratic Germany. Of these three countries, England has imposed the highest income taxation; yet, *the maximum rate in England is almost fifty per cent. less*

than the maximum rate in the House Bill. The Cabinets in these countries have undergone many changes in the course of the war. They include Socialists and Representatives of Labor. In the determination of their taxation program, they have had the assistance of the best economic brains in Europe. Those nations have had far longer experience than we in the science of government financing.

Yet not one of them has deemed it wise and advantageous to the state to impose rates of income taxation as high as those fixed by the House of Representatives. Surely, this fact and the economic considerations underlying it, are deserving to be seriously weighed by our legislators.

Does not the attitude of all the leading countries plainly indicate their recognition of the fact that the action and reaction of excessive income taxation create

a vicious circle from which the governments of all belligerent nations even in their extremity have shrunk?

And is it not a manifest dictate of reason that such burden of taxation as must be borne should be imposed gradually, as was in fact done everywhere in Europe, so as to give to all concerned a chance to adjust themselves to the new conditions, and not with one violent jerk? England imposed her present rate of income and excess profit taxes not in the first year of the war, but started on a much lower scale and by successive steps, in the course of nearly three years, attained the figures now prevailing.

We know that man and beast are capable of carrying far heavier weights if the strain is gradually increased than if the whole of the burden is dumped on their backs at once. The same holds good of economic strain.

Is it not plain that if the unprecedentedly high income taxation of the House Bill—exceeding as it does any rates ever imposed by any of the leading nations of the world—is enacted into law, the Government will find itself crippled in respect of taxable resources during the second year of the war; the very year which, if the war does last beyond the present one, will presumably be the crucial period.

Of course, the cost of the war must be laid according to the capacity to bear it. It would be fatuous folly and crass selfishness to wish it laid or endeavor to have it laid otherwise. All I am advocating in effect is that in the public interest not too much be exacted at once, but that by dividing the burden over a reasonable number of years, capital in no one year and especially not during the first year of the war, should be so exces-

sively taxed as to produce an unscientific and dangerous strain.

In addition to the concrete factors, there enter into this question certain psychological elements of a somewhat subtle character, but sufficiently definite and potent to be plainly discernible to those who are experienced in dealing with business affairs and with men of business, large and small.

I believe an income tax greatly increased over the rates heretofore prevailing, yet keeping within the bounds of moderation, would produce at least as large a total revenue as an exceedingly high one. And the consequences of the economic error of placing too vast a burden direct upon incomes would be more serious, I think, to the people in general than to the individuals directly concerned. The question of the individual is not the principal one. The essential

thing is that no undue strain be placed upon that great fund of capital as a whole which is derived from incomes of all kinds. It is this fund which in its turn is one of the vital forces necessary for the normal activities and progress of industry. If that fund is suddenly and too greatly reduced, the effect upon commerce and industry is liable to be abrupt and withering.

I yield to no one in my desire to see the burden upon the poor and those of moderate means lightened to the utmost extent possible.

I realize but too well that the load weighing at this time upon wage earners and still more perhaps upon men and women with moderate salaries is almost too great to be borne and certainly much greater than it should be. I wish a commission might be appointed, consisting of those best qualified in the entire country,

to apply themselves to this most serious, difficult and complex problem, indeed to the entire problem of excessively high prices. I hope they would discover means, if not to remedy the situation entirely, at least to alleviate it.

But I am convinced that relief cannot be found in taxation of incomes at rates without a parallel anywhere, and in unduly burdensome imposts upon business activities. I am convinced that certain theories being urged upon Congress and the people and to which the House War Revenue measure is in part responsive, while doubtless meant to tend and seemingly tending to a desirable consummation, are in fact bound, in their longer effect, to bring about results harmful to the community at large, rich and poor alike.

It is only that conviction which has emboldened me to state my views pub-

licly. In doing so I fully realized that I was running the risk of having my action misunderstood or misconstrued, and to be charged with selfishness and lack of patriotism.

Yet, I feel certain that in the end just recognition of their motives will not be withheld from those who, in defiance of the fleeting popularity of the plausible, venture to point out the dangers of impetuous action, however well intentioned, in the present emergency, and to urge that moderation and that regard for the lessons of history and of economics which can be left aside only at the peril of the general welfare.

Very faithfully yours,

(*Signed*) OTTO H. KAHN

P. S.—That you or any one else should even for a moment attach credence to the monstrous suggestion that capitalists

fomented America's entrance into the war because they feared that otherwise the amounts loaned by them to the Allies might be jeopardized or lost, is a truly distressing manifestation of the willingness of some of our people—I trust not many—to believe evil of men simply because they have been materially successful.

Leaving aside the cruel injustice of such an imputation, it attributes to moneyed men a degree of stupidity and of ignorance as to their own interests, of which they are not usually held guilty.

America loaned to the Allied nations, prior to our entrance into the war, roughly speaking, $2,000,000,000, of which sum all but a small fraction was loaned to England and France.

These loans were made almost entirely in the shape of bond issues which were widely distributed amongst individuals and institutions throughout this country.

Therefore, no very large portion of the aggregate is in the hands of any one person or institution.

To any one acquainted with financial affairs it is absolutely inconceivable that England or France would have defaulted on the relatively moderate amount of their foreign debt, whatever might have been the outcome of the war, if America had not joined.

Let us grant, for argument's sake, the wildly far-fetched supposition that in one way or another their internal debt might have become affected; it would still be utterly inconceivable that they would have permitted a default in their foreign debt, because it is, of course, suicidal for any nation to jeopardize its world credit.

But let us go still a step further and assume, in defiance of all reason, that even this totally inconceivable thing were to have happened. It would have meant, of

course, not a total and irrecoverable loss to the holders of obligations of the Allied countries, but merely a more or less temporary shrinkage of the value of such holdings.

A single year's war taxation will take out of the pockets of capitalists a great deal more than they could possibly have lost through depreciation in value of such amount of Allied bonds or loans as they may hold.

If you add to these considerations the circumstance that, owing to the intervention of our Government in financing and otherwise providing for the Allies, the commissions and profits of those who have heretofore dealt with the Allies will be largely cut off; that business will, quite rightly, be subjected to a large excess profits tax; that capital for years to come will have to pay increased taxes to provide for the debt incurred through the

war, for pensions, etc.; if you will reflect on these and various other patent considerations, you will realize that any rich man, fomenting for selfish reasons our entrance into the war, would be a fit subject for the immediate appointment of a guardian to take care of him and of his affairs.

II

The Actual Return Upon Taxable and Tax-Exempt Securities

Dear Sir:

Your letter indicates that you do not sufficiently realize the enormous advantage in interest yield which under the income tax schedule as fixed in the House Bill is possessed by tax-exempt securities as compared to taxable securities, especially, of course, in respect of large incomes.

Permit me to call your attention to the following eloquent facts:

The yield of tax-exempt securities at prevailing prices ranges from 3½% to nearly 4½%. *Under the rates fixed in the War Revenue Bill as it passed the*

House of Representatives, a taxable 6% investment would yield:

		PER ANNUM
2.28%	on incomes over	$2,000,000
2.34%	" " "	1,500,000
2.40%	" " "	1,000,000
2.69%	" " "	500,000
2.97%	" " "	300,000
3.26%	" " "	250,000
3.54%	" " "	200,000
3.90%	" " "	150,000
4.20%	" " "	100,000

Or, to put it in another way, the investment in 3½% "Liberty Bonds" is thus equivalent to investing in a taxable security yielding:

		PER ANNUM
9.21%	in respect of incomes over	$2,000,000
8.97%	" " " " "	1,500,000
8.75%	" " " " "	1,000,000
7.82%	" " " " "	500,000
7.07%	" " " " "	300,000
6.45%	" " " " "	250,000
5.93%	" " " " "	200,000
5.38%	" " " " "	150,000
5.02%	" " " " "	100,000

The investment in, say, New York City Bonds, being tax-exempt, at their present yield of 4.20%, would represent the following rates of income as compared to investments in taxable securities:

	PER ANNUM
11.05% in respect of incomes over	$2,000,000
10.76% " " " " "	1,500,000
10.50% " " " " "	1,000,000
9.38% " " " " "	500,000
8.48% " " " " "	300,000
7.74% " " " " "	250,000
7.12% " " " " "	200,000
6.46% " " " " "	150,000
6.02% " " " " "	100,000

Of course, all these figures hold good only for the period during which the proposed rates of income taxation would prevail. As the income tax rate decreases, the yield from tax-exempt securities diminishes proportionately.

The volume of tax-exempt securities at present outstanding, including the new

"Liberty Loan," is estimated at not less than $8,000,000,000.

The ability of corporations to find a ready market for their securities is a prerequisite for the continuance of business prosperity or, indeed, of adequate business activity. I need not elaborate the effect which the comparison of the income yield from tax-exempt securities as against taxable securities under an excessively high income tax schedule—even if confined to larger incomes—must necessarily have upon the eligibility of corporate securities for investment purposes. The conclusion seems unescapable that the resulting degree of disinclination to invest in such securities coupled with the impulse to dispose of existing holdings would bring about liquidation, severe shrinkage of values and more or less pronounced demoralization in the investment market—a condition of things which could

not fail in a measure to affect adversely the country's business in general, and which could only partially be counteracted by Government expenditures, however large.

As to your observations concerning the principle of tax-exempt issues, I believe the Government acted wisely, considering all the elements of the situation, in making its first great war issue, the Liberty Loan, tax free. But in the face of the figures above quoted, the question naturally presents itself whether our traditional policy of making Government issues tax-exempt should not be discontinued, which, of course, would mean that a materially higher rate of interest than 3½% would have to be paid for Government borrowing.

In theory, it seems to me, there can be little doubt that the balance of arguments is against the tax-exemption of Govern-

ment loans. As an abstract proposition little can be said, I think, in favor of a policy the effect of which gives an advantage to the rich and well-to-do, militates against the widest possible distribution of Government issues amongst the people, tends to facilitate Governmental extravagance by concealing the true cost and establishes a fictitious basis of national credit.

Thus, for instance, on the $1,000,000,000, or thereabouts, which our Government has loaned to the Allies at 3½% interest, it is losing money, because, whilst it nominally borrows this money through the Liberty Loan at 3½%, the cost to it is actually considerably higher because it loses the revenue which would accrue to it from the income tax if the bonds were not tax-exempt.

Let me add that I do not wish to be understood as suggesting that our Govern-

ment should charge to the Allied Nations more than the nominal rate at which it is borrowing. They have been fighting these three years and bringing unheard of sacrifices for a cause which we have recognized to be ours no less than theirs, and if we loan them money somewhat below its actual cost to us that item weighs but very lightly in the scale, especially also if we consider the immense monetary profits which our country has reaped from the sale to them of munitions, material and supplies.

However, as against the theoretical objections, some of which I have mentioned, to the tax-exemption of Government loans, there are certain "imponderabilia"—things which cannot be exactly weighed—in favor of a low rate of interest for Government borrowing, even if the lowness of the rate is to an extent fictitious. There are also certain practical

reasons for the maintenance of our traditional policy, and various concrete facts which must be taken into account. For instance, there is the problem of how to deal with the situation that might result from the withdrawal of deposits from savings banks and similar institutions, which probably would be liable to occur in case the Government offered a bond issue at the higher rate it would have to fix if the inducement of tax-exemption were removed.

There is the problem of the existence of billions of municipal and state securities which offer to the holder the privilege of freedom from municipal, state *and Federal* taxes. I understand that it is the consensus of opinion of our leading lawyers that under the legal theory which treats such issues as "instrumentalities of government" that privilege cannot be abridged and that Congress has no con-

stitutional power to tax state and municipal issues.

If state and municipal issues to be made during war time retain the feature of being free from taxation, can the Federal Government afford to make its war loans taxable, and thereby place itself in a position where it would have to borrow under conditions which would put it and its credit at a disadvantage as compared to state and municipal issues?

The problem is a complex one altogether and, like all economic questions, requires to be approached in a dispassionate spirit, giving due consideration to the reasons for and against. The temper of the stump speaker is not appropriate for dealing with taxation problems.

Let me add, in conclusion, that I fully agree that it is "sheer fiscal stupidity" and "socially inexpedient as well" to permit "mushroom fortunes" to be built out

of war profits. I believe there ought to be imposed a large excess war profits tax on the English model upon a fair and well conceived average basis of earnings so calculated as to take account of the vast difference in the country's industrial plant to-day and before the European war. Such a tax may not be entirely free from objections in theory, but from the social and moral point of view it is, I am convinced, thoroughly sound and proper and called for. Appropriate taxation of excess profits, together with an adequately though not exorbitantly heavy income tax would go a long way to prevent the enrichment of a class through the calamity of war, without at the same time affecting wages or laming the enterprise and business activities of the country.

Yours very truly,

(*Signed*) OTTO H. KAHN

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